# Insurance Outlook

## Market Outlook February 2022

The New Year has brought with it a key change to New Zealand's response to Covid-19. The shift from elimination to mitigation will present different challenges for business, the economy and the insurance market.

### Economic Summary

Many of the factors affecting the insurance market are also those that are placing strain on the New Zealand economy. The implications to the insurance market of the rise in inflation bringing increased costs, and limitations and delays within the global supply chain will be discussed later in this Outlook.

ANZ comments in its Economic Quarterly Outlook (December 2021) that 2022 will bring the 'Great Normalisation' as we learn to live with Covid-19 and gradually open our borders. It notes that a cautious approach is warranted when the last 18 months has shown how quickly economic conditions can change.

The New Zealand business sector is a mixed bag, both regionally and by industry. Construction is going gangbusters but the materialisation of housing risks, such as higher interest rates, tighter lending and a drop in prices could easily spill over to the residential construction industry and beyond.

Retail has experienced phenomenal growth as well, but household sentiment with the forecast of a cooling residential housing market implies that such growth may be short lived. We are all aware that having another summer without international tourists has hurt hospitality and related service industries hard.

However the good news is that New Zealand business confidence remains above pre-Covid-19 levels and domestic demand is still strong. There is a moderating trend at play that needs to be watched carefully through 2022, with higher labour costs, increased cost of materials and regulatory costs eating into the bottom line across many businesses.

Munich Re's Economic Research (February 2022) suggests that in the short term further disruption to global supply chains is another risk to watch. For example an Omicron wave in China could lead to supply chain bottlenecks lasting longer than expected. This would result in continuing inflationary pressure with negative effects for the New Zealand economy. Other factors such as sharp increases in energy prices, maybe as a result of the potential Russia-Ukraine conflict, could also trigger correspondingly higher inflationary pressure.

The pandemic has shown us that it is difficult to try and predict future economic trends. New Zealand's resilience, as we learn to live with Covid-19, will play a major part in the country's economic health. ANZ believes the Covid Protection Framework (traffic light system) will be as economically restricting as Alert Level 2 for the vaccinated and pleasingly we have already seen that the economy can continue to perform under such settings.



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**The Global Insurance Market**

**(All figures are converted to NZ$ at current exchange rates)**

There are three common themes influencing the global insurance market – the severity of natural disasters, higher inflation and restricted supply chains. These factors are strongly affecting the results of many insurers by both increasing the frequency and severity of losses, and impacting the cost and time to repair damage and to settle claims.

As an example there were 400 notable global natural disaster events recorded in 2021, down from 416 in 2020. However, the expense and severity of these events resulted in $516 billion in economic losses, compared with $495 billion for the prior year.

This led to 2021 being ranked as the third costliest year on record (adjusted for inflation) for economic loss due to natural catastrophes.

Q4 2021 was the 17th consecutive quarter of insurance rate increases across the global insurer market. Insurance companies have been fighting to grow their premium pool faster than their claims costs are growing and pleasingly we are now seeing the curve of price increases flatten but not halt. We still expect some price increases as insurance companies seek to get premiums to a sustainable level.

A good example is Lloyd's of London, which is one of the largest global insurers. In its H1 21 report it said that it had implemented 15 consecutive quarters of pricing increases across every class of business. As a result, their combined ratio (claims plus expenses divided by premiums) improved from 110.4% (97.0% excluding Covid-19 claims) in 2020 to 92.48% in 2021. So whilst Lloyd's is now making an underwriting profit, it is still seeking premium increases to get to a sustainable level that will create acceptable returns for shareholders.

The global insurance market relies heavily on reinsurance capacity to operate. Reinsurance is where insurance companies pass off some of their risk to other (re) insurers.

AM Best has reported a stable market outlook for the global reinsurance segment, citing in part the ongoing positive pricing momentum driven by enhanced underwriting discipline, including tighter terms and conditions, and a growing demand for reinsurance capacity.

However, AM Best also raise that the following factors are having a negative impact on global insurance and reinsurance markets;

- Historically low interest rates on fixed-income investments that are in most cases below the inflationary growth on historical loss reserves (i.e. the costs of claims that take time to settle are growing faster during their lifespan than the money that was invested to pay for them).
- Adverse loss reserve development in casualty (liability) lines of business due to sustained social inflation (i.e. increasing cost of litigation and liability during a claims life cycle)
- Losses and expenses for property lines of business affected by disruptions in the global supply chain and labour shortages
- Significant property catastrophe activity driven in part by climate trends.


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## The New Zealand Market

Not surprisingly it's a very similar story in the New Zealand market as most of the major New Zealand insurance companies are owned by international insurance companies which rely on the global reinsurance market to operate.

The largest insurer operating in New Zealand is Australian-based IAG which trades under the brands of NZI, AMI, State and Lumley, amongst others. In February IAG reported an insurance profit of $282 million for the six months to December, down 57.7% from the corresponding period in 2020. Much of this loss was driven by the impact of significant natural perils costs of $681 million, largely from severe weather events.

However, CEO and Managing Director Nick Hawkins says the business is on the right track under the "reset" programme he has implemented.

Suncorp NZ which trades under the brands Vero and AA Insurance expressed a similar sentiment:

"While our earnings have been impacted by weather events and investment markets, our underlying performance is strong and we are growing our market share," said Jimmy Higgins CEO.

Suncorp NZ experienced a nearly 35% decline in its profit for the half-year ended 31 December 2021. This was attributed mainly to weather-related claims in the previous six months which amounted to $72 million (a 41% increase). $52 million of this originated from just three weather events in July, August, and September.

In our September update we highlighted figures from the Insurance Council of New Zealand (ICNZ) that showed the cost of severe weather events in New Zealand in 2021 was $197 million. However, since that report the ICNZ has updated their 2021 data and the cost of weather related losses in New Zealand has risen to $321 million for 2021 and will no doubt continue to rise as more claims mature.

The largest loss of these reported weather events was flooding on the West Coast in July at $97.2 million, closely followed by a further flooding event on the West Coast in August at $62.29 million.

The West Coast has already experienced additional significant flooding events in 2022 and both Cyclones Cody and Dovi are expected to result in large insurance pay outs.

The constant impact of weather-related losses means that insurance alone will not be able to bear the brunt of the problem. The issue needs to be addressed on a wider platform where steps can be taken to build resilient communities and implement risk mitigation initiatives to attempt to reduce losses. New legislation has been introduced requiring the insurance industry (amongst others) to provide mandatory reporting on climate risks.

Despite these challenges, overall the New Zealand insurance market is in good health and stable. Capacity is still readily available for most sectors and insurers are very much open for business. Pricing remains firm as insurance companies continue to seek sustainable pricing models.

## Material Damage & Business Interruption



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Over 2021 and in 2022 to date there has been an unusual amount of large commercial fire losses.

These losses have occurred in a vast range of businesses and locations including an engineering business in Kaiapoi, a plastics factory in East Auckland, a Hamilton wood chipping business, a meat processing plant in Taranaki, a Matamata kayak company and a Tokoroa engineering company.

Whilst these are all unconnected and not part of any trend, the sudden aggregation of so many in a reasonably short space of time has raised some insurer eyebrows.

Overall this sector is profitable for the New Zealand market but we expect to see a continued effort from insurers to achieve overall premium/rate growth across their portfolio to counter losses and inflationary impacts. It is anticipated that rate rises for good risks will be between 2% and 5% depending on the insurance company.

The rising cost of inflation and the restrictive supply chain are increasing the cost of replacement. This is being felt when commercial buildings are revalued. It is important that all insureds maintain a current valuation of replacement costs on all assets, including buildings, because to rely on an old or outdated valuation may well result in underinsurance and potentially prejudice claims settlements.

In Wellington revaluations can cause a problem. The increased cost of reinsurance for Wellington based risks has driven some insurers to adopt a strategy of maintaining their existing commitments. For example if an insurer writes 100% of a $100 million building thereby holding $100 million of risk, when the building is revalued at $120 million that insurer may only wish to hold 83% of the risk, being the original $100 million. This means that there is shortfall of $20 million that will need to be found from a different insurer potentially at a higher premium.

There is still some pricing pressure on certain areas of the market. Risks such as buildings containing insulated panel construction (EPS) is one of these. We are also seeing a continued reluctance from insurers to accept risks that are involved with the recycling and waste management industries.

Where risks fall into these more challenging areas it is imperative the insurer market is engaged early, and solid underwriting submissions are presented to ensure the best outcomes can be achieved.

### Commercial Motor Vehicle

The pricing of motor vehicle insurance is generally set by claims performance. Fewer numbers of vehicles on the road during the various 2020 and 2021 lockdowns have dramatically altered the claims picture.

This means when insurers price a fleet at renewal they have to factor in a distorted 2020 and 2021 claims view and then overlay this with the other dynamics impacting claims. These elements include the escalating costs of repairing or replacing vehicles (including time delays from the supply chain), the impact of a tight labour market where the availability of experienced commercial drivers is challenging, and weather-related issues that have made driving conditions difficult.

Most insurers report their commercial motor books are performing well but all note the increasing costs of claims as a growing concern that will put pressure on pricing.



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## Business Travel

As countries begin to open their borders and travel slowly recommences, insurers continue to review their policy responses to Covid-19.

Whilst insurers generally still provide medical cover where an insured contracts Covid-19 when overseas, there are varying approaches to cover provided under other sections of Business Travel policies for claims due to cancellation, loss of deposits or other expenses etc. due to Covid-19.

Examples of some policy variances for Covid-19 cover are;

- Medical cover may be excluded if the insured is not fully vaccinated (even with a medical exemption)
- Cover may be excluded for trips which are 100% pure leisure travel (i.e. there is no business travel element)
- The policy may not respond if the insured has to isolate or is unable to travel due to being a 'close contact' of a Covid-19 case, but is not actually diagnosed with Covid-19.

As always, it is recommended travellers check websites such as www.safetravel.govt.nz to confirm if it is safe to travel to their intended destination, prior to booking flights and making other travel arrangements.

Once a decision to travel is made, managing the risk by booking cancellable flights and refundable accommodation can help, as well as understanding the fine print of the travel insurance policy.

## Marine

Weather-related losses and other large claims have influenced the overall performance in the marine sector and this is becoming especially apparent in the New Zealand Pleasure Craft market.

We have seen the withdrawal of Club Marine from the market and a change of appetite from other insurers to underwriting Pleasure Craft. The market is restricting the age of vessels (without a survey) and have clamped down on swing moorings, making some risks very difficult to place.

Following events such as the Tonga Tsunami, and Cyclones Cody and Dovi, some insurers are declining swing moorings entirely and cover for sea-based assets such as attenuators is extremely limited.

Marine Cargo premiums continue to be unsustainable for insurers and they are looking for gradual year-on-year rate adjustments to correct ratios and offset growing industry losses. The expectation for clients without losses is premium increases of 5% to 10% and where clients have poor loss records, insurers will look to increase premiums by over 10% and may also consider applying higher excesses. Sufficient time therefore needs to be allowed to negotiate terms.



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## Directors & Officers Liability (D&O)

The past 12 months has seen the D&O market in Australia become more stable following changes to legislation and corrections in the underwriting of the D&O portfolio. Rates are still rising there but at well below the 300% amount that was seen in 2018/2019. This is good news for the New Zealand D&O market that was reacting to what was happening in Australia.

The impact of the pandemic on New Zealand business has also not, to date, had the predicted effect of mass insolvencies so overall the New Zealand D&O market remains stable and insurers are willing to look at writing new business and extending existing policy limits.

Whilst insurers are generally seeking modest pricing increases for private companies, we are still experiencing larger increases for public companies. This is mainly due to the increased responsibilities directors are facing in the regulatory and conduct and culture areas.

It still remains vital that when seeking D&O insurance, a company is able to demonstrate its financial viability and the measures it has taken to mitigate potential impacts of the economic climate and the pandemic. It also continues to be important to allow plenty of time for arranging D&O insurance.

## Professional Indemnity

With a strong economic environment including a vibrant residential property market, the Professional Indemnity (PI) market is stable with good capacity and a number of insurers competing for business. However, with some uncertainty of where the economy will go next, we expect insurers to be cautious when looking at PI cover. Often an economic down turn and a falling residential property market correlate with an increase in PI claims from sectors such as property valuers, real estate agents, lawyers and conveyancers, investment advisers and trusts.

For construction-related risks and financial institutions, the market conditions remain challenging with insurers still remediating their portfolios through a combination of rate increases, capacity reductions, higher excesses and coverage limitations.

For most other professions and occupations there is good appetite from New Zealand insurers.

## General Liability

The lack of exposure to bodily injury claims in New Zealand means that capacity is widely available and pricing is generally competitive. Insurers have sought modest premium increases in recent years, however where an insured is able to demonstrate effective risk management and a clean claims record, rate increases can be minimised.

There are certain industry sectors where insurers are seeking larger premium increases and requiring more comprehensive underwriting information. An example is risks that have exposure in the United States of America (US), either physically or through product exports.



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## Cyber

In September's update we commented that Cyber is probably the most volatile class of insurance and this continues to be the case.

Internationally it is being reported that in Q4 21 Cyber insurance premiums increased 130% in the US and 92% in the United Kingdom (UK), driven mainly by the continued increase in the frequency and severity of ransomware claims, with many insurers seeking to tighten coverage terms and conditions.

We are continuing to see an increase in claims in New Zealand. In 2021 CERT NZ issued several alerts including:

- The Java software component called Log4j has a vulnerability allowing attackers to use it to illegally access systems and services
- An Apple weakness could allow an attacker to access a person's phone, iPad, computer or watch without authorisation
- FluBot malware infecting Android phones
- Critical security issues in Adobe Acrobat and Adobe Reader. Opening a malicious PDF file in a vulnerable version could allow an attacker to gain access to a device
- Critical vulnerabilities identified in Microsoft Windows.

The result of increasing risk and claims is that we are seeing many insurers:

1. Increase premiums
2. Restrict coverage
3. Demand much more information.

In New Zealand, premiums have been increasing anywhere from 20% upwards. Sub limits are sometimes being applied for ransomware claims and new exclusionary language being applied to end-of-life software is becoming the norm.

Nearly every insurer will require verification of at least some preventative controls, which will likely include multifactor authentication, remote desktop protocol, data backup practices, segregation of networks, encryption, patch management, privileged account management, employee training and a host of others.

Applications often require additional ransomware questionnaires that may include dozens of questions on controls specially designed to prevent or mitigate ransomware attacks.

Without some of these controls in place, many insurers will not quote. It is therefore paramount to start the application process for Cyber insurance as early as possible.



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## Conclusion

With the backdrop of a somewhat uncertain economy it is reassuring that the New Zealand insurance market remains stable. While across many classes of insurance insurers are seeking increases, these are in line with other industry sectors given the impact of inflation and supply chain disruptions.

There are, however, pockets where the market is more difficult. As the year develops, capacity for Wellington property will make an interesting watch both in price and availability.

Risks impacted by weather events will come under growing scrutiny as climate-based claims continue to cause the biggest single impact to both the global and the New Zealand insurance markets. We expect that Material Damage insurers will pay close attention to a property's exposure to flood and coastal erosion and Marine insurers will be cautious around exposed assets such as marinas and swing moorings.

And of course the risks around Cyber will continue to evolve.

To mitigate these premium increases, early engagement with the insurer is recommended and it is vital that all pertinent information is supplied to present a risk in the best light possible.

The old industry adage that "insurers fill gaps in information with premium dollars" has never been more appropriate in a market where insurers want to take a more granular look at each risk.



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